Sumatec Engineering and Construction Sdn Bhd v Malaysian Refining Co Sdn Bhd

FEDERAL COURT (PUTRAJAYA) — CIVIL APPEAL NO 02(I)–27 OF 2011 (W)
ARIFIN ZAKARIA CHIEF JUSTICE, HASHIM YUSOFF AND ABDULL HAMID EMBONG FCJJ
29 FEBRUARY 2012

Civil Procedure — Injunction — Injunction to restrain calling of bank guarantee payment — Whether unconscionable conduct on part of beneficiary ground to restrain calling on bank guarantee — Test for establishing unconscionability — Failure to establish unconscionable conduct — Balance of convenience favouring refusal of injunction

Contract — Guarantee — Bank guarantee — Injunction to restrain calling of bank guarantee payment — Whether unconscionable conduct on part of beneficiary ground to restrain calling on bank guarantee — Test for establishing unconscionability — Failure to establish unconscionable conduct — Balance of convenience favouring refusal of injunction

The appellant ('Sumatec') was appointed by the respondent ('MRC') to be its contractor for a steel works contract. As per the terms of the contract, Sumatec was required to provide a bank guarantee for the due performance of the contract for 10% of the contract value. The full contract sum as initially agreed by the parties was RM47,846,688 and accordingly Sumatec procured a bank guarantee for RM4,784,668.80. Sumatec claimed that their works were seriously hindered by delays on the part of the MRC. Sumatec further claimed that subsequent variation to the contract had the effect of reducing the contract value to about RM13m only. The bank guarantee issued still remained in force notwithstanding the variation in the total value of works. Upon completion of the works by Sumatec, MRC claimed for back charges without any notice of defects or opportunity given to Sumatec to rectify any such defects and despite a provisional acceptance certificate having being issued. MRC then made a demand for payment on the bank guarantee. Sumatec contended that MRC in doing so was acting mala fide. The learned High Court judge held that the demand made by MRC was unconscionable and thus granted Sumatec an injunction to restrain MRC from calling upon the bank guarantee. The Court of Appeal accepted that unconscionability can be an exception but allowed MRC's appeal on the grounds that MRC had not acted unconscionably in making the call on the bank guarantee. Sumatec appealed to the Federal Court on the following question: 'Whether 'unconscionable conduct' on the part of a

beneficiary of a bank guarantee or a performance bond is a distinct ground, apart from 'fraud', that entitles the court to restrain the beneficiary from calling on or demanding and receiving monies under the bank guarantee or performance bond.'

Held, dismissing the appeal with costs:

(1) In the case of on demand letters of guarantee or performance bonds the courts are now more willing to look beyond the fraud exception and consider unconscionability as a separate and independent ground to allow for a restraining order on the beneficiary (see para 33).

(2) The 'seriously arguable and realistic inference' test as used in *Focal Asia Sdn Bhd & Anor v Raja Noraini binti Raja Datuk Nong Chik & Anor* [2009] 1 LNS 913 is equally applicable to the extended exception of unconscionability. That test therefore needs to be applied to the relevant material facts before the court; *Kejuteraan Bintai Kindenko Sdn Bhd v Nam Fatt Construction Sdn Bhd & Anor* [2011] 7 CLJ 442 referred (see paras 39–40).

(3) Sumatec had raised several incidences of the alleged unconscionable conduct on the part of MRC. These were factual matters which had been carefully evaluated and answered below in the Court of Appeal. The learned judges rightly concluded based on the materials before them, that unconscionability had not been proven to maintain the injunction granted below. There were no reasons to justify an interference with the appellate judges' exercise of their discretion to set aside the injunction. Further, the balance of convenience favoured refusal of the injunction (see para 43).

[Bahasa Malaysia summary

Perayu ('Sumatec') dilantik oleh responden ('MRC') untuk menjadi kontraktornya bagi kontrak kerja-kerja besi. Mengikut terma-terma kontrak, Sumatec dikehendaki memberi jaminan bank untuk pelaksanaan kontrak 10% daripada nilai kontrak. Jumlah kontrak penuh seperti yang dipersetujui pada mulanya oleh pihak-pihak adalah RM47,846,688 dan dengan itu Sumatec mendapatkan jaminan bank untuk RM4,784,668.80. Sumatec mendakwa bahawa kerja-kerja mereka secara serius dihalang dengan kelewatan oleh pihak MRC. Sumatec selanjutnya mendakwa bahawa variasi berikutnya kepada kontrak tersebut mempunyai kesan mengurangkan nilai kontrak kepad lebih kurang RM13 juta sahaja. Jaminan bank yang dikeluarkan kekal berkuat kuasa tanpa mengira variasi dalam jumlah keseluruhan nilai kerja-kerja. Atas penyiapan kerja-kerja oleh Sumatec, MRC menuntut untuk caj-caj tertunggak tanpa apa-apa notis kecacatan atau peluang diberikan kepada Sumatec untuk membaiki apa-apa kecacatan sedemikian walaupun sijil penerimaan sementara telah dikeluarkan. MRC kemudiannya membuat tuntutan untuk bayaran

jaminan bank tersebut. Sumatec berhujah bahawa MRC dalam berbuat demikian bertindak secara mala fide. Hakim Mahkamah Tinggi memutuskan bahawa tuntutan yang dibuat oleh MRC tidak adil dan oleh itu memberikan Sumatec injunksi untuk menghalang MRC daripada meminta bayaran atas jaminan bank tersebut. Mahkamah Rayuan menerima bahawa tindakan tidak adil tersebut boleh menjadi pengecualian tetapi membenarkan rayuan MRC atas alasan-alasan bahawa MRC tidak bertindak tidak adil dalam meminta pembayaran atas jaminan bank tersebut. Sumatec merayu ke Mahkamah Persekutuan atas soalan berikut: 'Whether 'unconscionable conduct' on the part of a beneficiary of a bank guarantee or a performance bond is a distinct ground, apart from 'fraud', that entitles the court to restrain the beneficiary from calling on or demanding and receiving monies under the bank guarantee or performance bond.'

Diputuskan, menolak rayuan dengan kos:

(1) Dalam kes surat-surat tuntutan jaminan atau prestasi bon mahkamah-mahkamah sekarang bersedia melihat pengecualian fraud seterusnya dan mempertimbangkan tindakan tidak adil sebagai alasan berasingan dan bebas untuk memberikan perintah menghalang kepada benefisiari (lihat perenggan 33).

(2) Ujian 'seriously arguable and realistic inference' seperti yang digunakan dalam kes *Focal Asia Sdn Bhd & Anor v Raja Noraini binti Raja Datuk Nong Chik & Anor* [2009] 1 LNS 913 adalah beraplikasi dengan sama kepada pengecualian tindakan tidak adil seterusnya. Ujian tersebut oleh itu perlu dipakai kepada fakta material yang relevan di hadapan mahkamah; *Kejuteraan Bintai Kindenko Sdn Bhd v Nam Fatt Construction Sdn Bhd & Anor* [2011] 7 CLJ 442 dirujuk (lihat perenggan 39–40).

(3) Sumatec telah membangkitkan beberapa kejadian mengenai dakwaan tindakan tidak adil oleh MRC. Ini adalah perkara fakta yang telah dinilaikan secara teliti dan dijawab oleh Mahkamah Rayuan. Hakim-hakim yang bijaksana memutuskan dengan betul berdasarkan material di hadapan mereka, bahawa tindakan tidak adil tersebut tidak dibuktikan untuk mengekalkan injunksi yang diberikan oleh Mahkamah Tinggi. Tidak terdapat alasan untuk menjustifikasikan campur tangan dengan pelaksanaan hakim-hakim mahkamah rayuan terhadap budi bicara mereka untuk mengenepikan injunksi tersebut. Selanjutnya, imbangan kebarangkalian memihak kepada penolakan injunksi (lihat perenggan 43).]

Cases referred to

Bains Harding (Malaysia) Sdn Bhd v Arab-Malaysian Merchant Bank Bhd & Ors [1996] 1 MLJ 425, HC (refd)

Bank of Nova Scotia v Angelica-Whitewear (1987) 36 DLR (4th) 161, SC (refd)
Bocotra Construction Pte Ltd & Ors v Attorney General (No 2) [1995] 2 SLR 733, CA (refd)
CDN Research Development Ltd v Bank of Nova Scotia (1980) 18 CPC 62, HC (refd)
Edward Owen Engineering Ltd v Barclays Bank International Ltd [1978] 1 All ER 976; [1978] QB 159, CA (refd)
Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd [1995] 1 MLJ 149; [1995] 1 CLJ 283, SC (refd)
Focal Asia Sdn Bhd & Anor v Raja Noraini binti Raja Datuk Nong Chik & Anor [2009] 1 LNS 913, HC (folld)
GHL Pte Ltd v Unitrack Building Construction Pte Ltd [1999] 4 SLR 604, CA (refd)
Harbottle v National Westminster Bank [1978] QB 146, QBD (refd)
IE Contractors v Lloyd's Bank [1990] Lloyd's Rep 496, CA (refd)
Kejuteraan Bintai Kindenko Sdn Bhd v Nam Fatt Construction Sdn Bhd & Anor [2011] 7 CLJ 442, CA (folld)
LEC Contractors (M) Sdn Bhd (formerly known as Lotteworld Engineering & Construction Sdn Bhd) v Castle Inn Sdn Bhd & Anor [2000] 3 MLJ 339; [2000] 3 CLJ 473, CA (refd)
Nafas Abadi Holdings Sdn Bhd v Putrajaya Holdings Sdn Bhd & Anor [2004] MLJU 148, HC (refd)
New Civilbuild Pte Ltd v Guobena Sdn Bhd & Anor [1999] 1 SLR 374, HC (refd)
Newtech Engineering Construction Pte Ltd v BKB Engineering Constructions Pte Ltd and Others [2003] 4 SLR 73, HC (refd)
Olex Focas Pty Ltd v Skodaexport Co Ltd (1998) 3 VR 380, CA (refd)
Radio & General Trading Co Sdn Bhd, The v Wayss & Freytag (M) Sdn Bhd [1998] 1 MLJ 346, HC (refd)
Samwoh Asphalt Premix Pte Ltd v Sum Cheong Piling Pte Ltd & Anor [2002] 1 SLR 1, CA (refd)
Satriadesa Corporation Sdn Bhd v Tenaga Nasional Bhd [2009] MLJU 1404, HC (refd)
Stern v McArthur (1988) 165 CLR 489, HC (refd)

Appeal from: Civil Appeal No W–02 (IM)(NCC)–3223 of 2010 (Court of Appeal, Putrajaya)

Alex De Silva (Melinda D'Angelus with him) (Bodipalar Ponnudurai De Silva) for the appellant.
Azlan Sulaiman (Azmi & Associates) for the respondent.

Abdull Hamid Embong FCJ (delivering judgment of the court):

[1] In the High Court the appellant here ('Sumatec') succeeded in obtaining

an injunction to restrain the respondent here ('MRC') from calling upon a bank guarantee issued by Bank Islam Malaysia Bhd ('BIMB'). The High Court also dismissed MRC's application to set aside an earlier exparte injunction order dated 4 June 2010 obtained by Sumatec to the same effect.

[2] The exparte interlocutory application by Sumatec in the High Court was for the following prayers:

(a) to restrain the MRC from calling upon the bank guarantee issued by BIMB;

(b) alternatively, if a demand had been made by the MRC, for MRC to be restrained from receiving the sum guaranteed thereunder;

(c) further alternatively, if any sum have been released by the BIMB to MRC, MRC to be restrained from utilising or dealing with such sums pending determination and disposal of Sumatec's claim in this suit or further order; and

(d) A further order sought against MRC was to the effect that, if the monies under the bank guarantee had been received by the MRC from the BIMB, MRC was to be directed to refund such monies to BIMB in the meanwhile.

[3] The background facts had been clearly set out in the judgment of the trial judge and suffice for us to reproduce them (with some editing):

(a) by a letter of award dated 9 May 2008 Sumatec was appointed by MRC to be its contractor for the design, supply, fabrication and erection of structural steel for the Melaka Refinery PSR-2 Revamp Project at Sungei Udang, Melaka ('the structural steel works contract').The parties subsequently entered into a contract in writing for this structural steel works. This was a bill of quantities contract;

(b) by another letter of award dated 15 May 2008 Sumatec was also awarded a contract for the civil works related to the same project ('the civil works contract');

(c) this present proceedings only involves the structural steel works contract. As per the terms of this aspect of the contract Sumatec was required to complete the works by 31 May 2009;

(d) Sumatec was also to provide a bank guarantee for the due performance of the contract for 10% of the contract value of the structural steel works. The full contract sum as initially agreed by the parties was RM47,846,688 and accordingly Sumatec procured a bank guarantee from BIMB for the sum of RM4,784,668.80 with the MRC as the named beneficiary. The bank guarantee was to be valid until three

months after expiry of the warranty period, which in turn was twelve months after the date of provisional acceptance of the works as certified by issue of a provisional acceptance certificate;

(e) Sumatec claimed that their works were seriously hindered by delays on the part of the MRC to supply complete drawings and this had a knock-on effect on the production and fabrication of steel structures for the MRC's project. Further, it is alleged, that there were no specific milestones set for completion of parts or stages of the works but that the completion date set for the 31 May 2009 was for the overall works;

(f) it was Sumatec's further claim that MRC had proceeded to reduce the scope of Sumatec's works by removing certain aspects of the works, like the erection of the steel structures, from Sumatec original scope of works. This variation was confirmed on 16 June 2009. In effect the value of the remaining contractual works had by that move now been reduced to about RM13m only from the original contract value of about RM47m. The bank guarantee issued still remained in force notwithstanding this variation in the total value of works;

(g) Sumatec also asserted that they had by 31 May 2009 duly completed all works required of them under the reduced scope of contract by delivery of all agreed steel structure;

(h) MRC had confirmed this, it is alleged, by the issuance of a provisional acceptance certificate on 17 November 2009 which certified that Sumatec's contractual works had been carried out and completed as of 31 May 2010;

(i) upon completion of their works as aforesaid, Sumatec had raised with MRC two claims for unpaid monies amounting RM4,338,684.48;

(j) it is alleged by Sumatec that MRC in turn had introduced a claim for back charges without any notice of defects or opportunity given to Sumatec to rectify any such defects if at all, and this was in disregard to the terms of the contract between them. Sumatec stated that this claim of MRC had been and continues to be seriously disputed by Sumatec and further highlighted the fact that the provisional acceptance certificate had been issued to Sumatec in November 2009 notwithstanding this claim for 'back charges';

(k) Sumatec produced records, in the form of minutes of meetings and correspondences to show that the parties had and continued to be engaged in active negotiations to resolve their disputes and finalise the 'Final Account' as between them when Sumatec was informed on 1 June 2010 by BIMB that MRC had made a demand for payment or encashment of the bank guarantee; and

(l) it was against this backdrop that MRC had proceeded to make the

demand on the bank guarantee. Sumatec contends that MRC in doing so was acting mala fide, with an intention to enrich itself and/or 'steal a march' on it.

[4] The Court of Appeal had on 7 February 2011 allowed MRC's appeal concluding that the balance of convenience tipped in favour of MRC and that damages would at the end of the day be a sufficient remedy for Sumatec. It also found that MRC was not guilty of any unconscionable conduct to restrain it from calling on the bank guarantee.

THE OPPOSING CONTENTIONS

[5] Sumatec strongly contended that MRC's call on the bank guarantee amounts to unconscionable conduct and this in itself is sufficient ground to challenge the calling for payments under the said bank guarantee.

[6] Sumatec argued that 'unconscionability' or unconscionable conduct is a separate and distinct exception to the accepted exception that only in the case of a fraud could the court grant a restraining order and that there were circumstances in this case to establish unconscionable conduct.

[7] The following circumstances were cited in submission as evidence of the alleged unconscionable conduct on the part of MRC:

(a) there was an agreement in principle reached by the parties for the bank guarantee to be reduced. This was in tandem with the reduction in the scope of works from that originally contracted for between MRC and Sumatec. It referred to the minutes of the meeting between the parties held on 29 October 2009 stating that:

> Liability, Warranty and Performance Bond: MRC *confirmed that Sumatec could reduce the value of their performance bond* in line with a value to be proposed by MRC.

The original contract sum was RM47,846,688. This was reduced to a sum of approximately RM13m.

(b) A provisional acceptance certificate had been issued to MRC for works performed to completion by Sumatec up to 31 May 2009. The certificate certified that the works completed up to 31 May 2009 by Sumatec was in the main accepted as satisfactory to MRC;

(c) MRC had no claims for any LAD for any delay and neither had MRC raised any other complaints/disputes, if at all Sumatec was in default;

(d) there was a one year gap between the date when the completed works was provisionally accepted and the date of the demand of the bank guarantee without any explanation by MRC;

(e) there is clear evidence of a reduction of Sumatec's scope of works under the contract to a region of about RM13m only. Accordingly, the demand on the bank guarantee for RM4,535,255.67 was equivalent to 40% of the value of the actual total contract sum. This amount was wholly disproportionate bearing in mind that the bank guarantee specifically sets the limit of the guaranteed sum at 10% of the contract sum; and

(f) from the minutes of the meeting between the parties, it is evident that the parties had agreed in principle to reduce the value of the bank guarantee to reflect the reduction of Sumatec's scope of works and the reduction in the contract value. Notwithstanding the same, MRC proceeded to make a call on the bank guarantee.

[8] MRC on the other had contended that the bank guarantee was unconditional in nature and on-demand in character and thus cannot be restrained from being called and for payment to be made out to it by BIMB.

[9] It was submitted by learned counsel of MRC that only fraud which has been brought to the notice of the bank is the recognised exception. It was contended too that fraud must be clearly established and that here no fraud had occurred in their notice to the bank.

[10] MRC also contended that there was no merit to the allegation that their call on the bank guarantee was made in bad faith. MRC argued that bad faith or unconscionable conduct is not an exception to the generally accepted rule by Malaysian courts that only fraud can be a ground to injunct any payment out of a bank guarantee once a valid written demand has been made by a beneficiary.

THE QUESTION

[11] Before us, leave to appeal was allowed on this sole question of law, namely:

> Whether 'unconscionable conduct' on the part of a beneficiary of a bank guarantee or a performance bond is a distinct ground, apart from 'fraud', that entitles the Court to restrain the beneficiary from calling on or demanding and receiving monies under the bank guarantee or performance bond.

[12] Learned counsel for Sumatec informed us that in recent times the Malaysian courts have begun to recognise the element of unconscionability as a distinct ground for restraining the beneficiary from calling on or demanding moneys under the performance bond. He advised us however that the apex court has never yet dealt with this matter. A number of High Court decisions supporting the unconscionability ground were brought to our attention. They are:

(a) *Nafas Abadi Holdings Sdn Bhd v Putrajaya Holdings Sdn Bhd & Anor* [2004] MLJU 148;

(b) *Satriadesa Corporation Sdn Bhd v Tenaga Nasional Bhd* [2009] MLJU 1404;

(c) *Focal Asia Sdn Bhd & Anor v Raja Noraini binti Raja Datuk Nong Chik & Anor* [2009] 1 LNS 913; and

(d) *The Radio & General Trading Co Sdn Bhd v Wayss & Freytag (M) Sdn Bhd* [1998] 1 MLJ 346.

[13] From neighbouring Singapore, four cases were cited to support this contention. They are:

(a) *Bocotra Construction Pte Ltd & Ors v Attorney General (No 2)* [1995] 2 SLR 733;

(b) *GHL Pte Ltd v Unitrack Building Construction Pte Ltd and another* [1999] 4 SLR 604;

(c) *Newtech Engineering Construction Pte Ltd v BKB Engineering Constructions Pte Ltd and Others* [2003] 4 SLR 73; and

(d) *Samwoh Asphalt Premix Pte Ltd v Sum Cheong Piling Pte Ltd & Anor* [2002] 1 SLR 1.

[14] The learned High Court judge accepted that the demand made by MRC, in the particular circumstances of this case was unconscionable and that this may be a ground for the court's intervention in granting the restraining order. That, despite the demand being valid and that the bank guarantee here was an on demand and unconditional bank guarantee. This can be seen from the clear words of the preamble and cl 1 of the bank guarantee itself, which states:

> If the CONTRACTOR shall in any respect fail to execute the CONTRACT or commit any breach of its obligations thereunder as certified by MRC, the GUARANTOR shall pay to MRC on first notice and without any proof and conditions the sum of Ringgit Malaysia: Four Million Seven Hundred Eighty Four Thousand Six Hundred Sixty Eight and sent Eighty Only (RM 4,784,668.80) being 10% (ten percent) of the CONTRACT PRICE.

[15] The Court of Appeal also came to the same conclusion on the nature of the bank guarantee ie that it was an on-demand guarantee. We affirm these contractual interpretations of the bank guarantee as being an on-demand one; as can be seen from the clear terms in its preamble.

[16] The Court of Appeal however disagreed with the High Court in concluding that MRC had acted unconscionably. The learned judges of appeal accepted that unconscionability can be an exception. Their Lordships however came to a finding of facts that, in the instant case, Sumatec had failed to adduce sufficient evidence of unconscionable conduct on the part of MRC in making the call on the bank guarantee.

[17] The Court of Appeal used the following tests and principles in coming to its conclusion, in determining the issue at hand as found in the following passages from its judgment:

(i) The principle concerning 'unconscionability' was initially propounded by Lord Denning in the case of *Lloyds Bank v Bundy* [1975] QB 326 where it was held that unconscionable transaction between parties may be set aside by the court of equity. This 'unconscionable' category is said to extend to all cases where unfair advantage has been gained by an unconscientious use of power by a stronger party against a weaker (see also *Halsbury's Law of England*, (3rd Ed), Vol 17 [1956] at p 682).

(ii) On an application for relief against unconscionable conduct, the court looks to the conduct of the party attempting to enforce, or retain benefit of, a dealing with a person under a special disability in circumstances where it is not consistent with equity or good conscience that he should do so (see *Commercial Bank of Australia Ltd v Amadio and Another* [1983] 46 ALR 402).

(iii) In the Singapore High Court, Lai Kew Chai J in the case of *Min Thai Holdings Pte Ltd v Suniable Pte Ltd & Anor* [1999] 2 SLR 368 opined that 'the concept of

unconscionabiiity involves unfairness, as distinct from dishonesty or fraud, or conduct so reprehensible or lacking in good faith that a court of conscience would either restrain the party or refuse to assist the party'.

(iv) It is not possible to define 'unconscionability' other that to give some very broad indications such as lack of bona fides. What kind of situation would constitute 'unconscionability' would have to depend on the facts of each case. This is a question which the court has to consider on each occasion where its jurisdiction is invoked. There is no pre-determined categorisation (see *Dauphin Offshore Engineering and Trading Pte Ltd v The Private Office of HRH Sheikh Sultan bin Khadifa bin Zayed Al-Nahyan* [2000] 1 SLR (R) 117; and *Shanghai Electric Group Co Ltd v PT Merak Energi Indonesia* [2010] 2 SLR 329)

(v) Based on the above considerations, we are of the view that there is no simple formula that would enable the court to ascertain whether a party had acted unconscionably in making a call on an on-demand performance bond or bank guarantee. In the final analysis, whether or not 'unconscionability' has been made out is largely dependent on the facts of each case. In every case where 'unconscionability' is made out, there would always be an element of unfairness or some form of conduct which appears to be performed in bad faith.

(vi) In *Bocotra Construction Pte Ltd v AG* [1995] 2 SLR (R) 262, the Singapore Court of Appeal, stated that 'a higher degree of strictness applies, as the applicant will be required to establish a clear case of fraud or unconscionability in the interlocutory proceedings. It is clear that mere allegations are insufficient'.

[18] Of the various propositions on the concept of unconscionabiiity that emerged from the case authorities adverted to in the judgment of the Court of Appeal, three entrenched principles may be discerned, as observed by Kartigesu JA speaking for the Singapore Court of Appeal in *Bocotra*. They are:

(a) the autonomy principle — the guarantee constitutes a separate contract from the underlying transaction between the account party and the beneficiary; its privity being only between the beneficiary and the issuing bank;

(b) the 'cash in hand' principle — reflecting the importance of promoting commercial efficacy and certainty in the use of letters (of credit) guarantees and bonds. This ties in with the autonomy principle; and

(c) the 'fraud' exception — the sole exception to the autonomy and cash in hand principles arises where the plaintiff can establish fraud in the circumstances of the call or payment. This permits injunctive relief.

[19] The fundamental principle behind a bank guarantee is that it is separate and independent of the underlying contract between the disputing immediate parties and the contract between the account party and the bank. Thus in this

case, MRC could, relying on this autonomy principle, call upon BIMB to make payment on the bank guarantee at any time and without proof of any breaches arising from the underlying contract.

[20] However the rigidity of this autonomy principle could sometimes produce injustice. In English law the now well accepted single exception of fraud was recognised by the courts to counter any injustice that may arise from a call or payment on the bank guarantee. And the reason is this; the certainty of payment to the beneficiary under the autonomy principle has tipped the balance of risk heavily in favour of the beneficiary, sometimes resulting in inequitable result to the account party whilst achieving the desired commercial result, (see article by *Jeffrey J Browne: The Fraud Exception to Standby Letters of Credit in Australia: Does it Embrace Statutory Unconscionability? Bond Law Review* Vol II Issue 1, 6 January 1999).

[21] The fraud exception relies upon the maxim *ex turpi causa non oritur actio* (no action arises out of a dishonourable cause). The fraud exception is thus recognised to balance the risks between the parties.

[22] This strict approach towards the non interference by the courts on the bank's obligations is best explained in this oft-quoted passage of Kerr J in *Harbottle v National Westminster Bank* [1978] QB 146 who said:

> It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration as available to them or stipulated in the contracts. The courts are not concerned with the difficulties to enforce such claims; these are risks which the merchants take.

[23] And to further emphasise that banks should be 'left free to honour its contractual obligation' these passages from *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159 may be quoted, where Sir John Donaldson MR, speaking for the Court of Appeal said:

(1) In requesting his bank to issue such a letter, bond or guarantee, the customer is seeking to take advantage of the unique characteristic. If, save in the most exceptional cases, he is to be allowed to derogate from the bank's personal and irrevocable undertaking, given be it again noted at his request, by obtaining an injunction restraining the bank from honouring that undertaking, he will undermine what is the bank's greatest asset, however large and rich it may be, namely its reputation for financial and contractual probity.

(2) The wholly exceptional case where an injunction may be granted is where it is

> proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear, both as to the fact of fraud and as to the bank's knowledge.

[24] The above quoted passage from *Harbottle* was also used by our then Supreme Court in *Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd* [1995] 1 MLJ 149; [1995] 1 CLJ 283, as a basis to hold that a performance bond, which the Supreme Court likened to a pure on-demand guarantee, is independent of the underlying contract between the disputing parties, and that it is not open for the courts to inquire into any breach of obligations in the underlying contract. The Supreme Court found that it was wrong for the High Court to allow the interim injunction to restrain the appellant/purchaser from receiving the moneys under the said performance bond.

[25] Unconscionability as an added and distinct exception to restrain payments in on demand guarantees has lately made some inroad into some common law jurisdictions. Thus in Singapore some authorities, notably *Bocatra* unconscionability was introduced seemingly as an additional ground for restraining a call or payment on a bank guarantee although the concept was not accorded a full discussion in that case. One view as observed by Hang Yen Low in his very useful article entitled 'Unconscionability As A Ground For Withholding Payment In Demand Guarantees: Should The Exception Be Extended To Letters Of Credit? [2008] 1 MLJ clxxxiii' is that since unconscionability and fraud are terms used interchangeably in *Bocatra* and that the court did not investigate the facts relating to the underlying contract the judgment 'was specifically tailored to dispel the notion that fraud was not the sole ground for an interim injunction'. Thus it would seem that *Bocatra* does not depart from the English position. This view was supported in *New Civilbuild Pte Ltd v Guobena Sdn Bhd & Anor* [1999] 1 SLR 374 where the learned JC stated that:

> Given that the Court of Appeal had stated that the weight of authority had suggested that fraud as the sole exception was well entrenched, I do not understand the court as having changed the law without a discussion of the basis for it.

[26] However in *GHL Pte Ltd v Unitrack Building Construction Pte Ltd* [1999] 4 SLR 604 — the Court of Appeal took a forward leap in holding that unconscionability alone could constitute a ground for restraining a call for payment under a performance bond and that *Bocatra* had been 'a conscious departure from the English position'. Unconscionability has thus found a sound footing as a distinct exception in Singapore.

[27] In Malaysia there have been some attempts in the High Courts to adopt

the concept of unconscionability as an additional exception. Learned counsel for the appellant referred us to those High Court cases we had mentioned earlier.

[28] MRC of course took the stand that unconscionability is not a ground to restrain a beneficiary's call on a bank guarantee. The following cases were cited in support:

(a) Supreme Court — *Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd* [2000] 3 MLJ 339; [1995] 1 MLJ 149;

(b) Court of Appeal — *LEC Contractors (M) Sdn Bhd (formerly known as Lotteworld Engineering & Construction Sdn Bhd) v Castle Inn Sdn Bhd & Anor* [2000] 3 CLJ 473; and

(c) High Court — *Bains Harding (Malaysia) Sdn Bhd v Arab-Malaysian Merchant Bank Bhd & Ors* [1996] 1 MLJ 425.

[29] In *Bains Harding* the concept of unconscionability was interchangeably used with fraud, where it was found that the defendants were guilty of fraud, (although not pleaded) and had acted in bad faith and in an unconscionable manner to justify the granting of an interlocutory injunction to the plaintiff to restrain the defendants from accepting any money from the bank under the bank guarantees. In coming to his decision the learned judge went into a full fledged inquiry into the parties conduct, the terms of the underlying contract and supplementary agreements, the respective performance of the obligations of both parties, and also the determination on whether a breach of any of the agreements had occurred. The court also found that the balance of convenience favoured the plaintiff and that damages would not be an adequate remedy to the plaintiff. There was however no finding made that the bank had notice of the fraud, a necessary requirement as held in *Esso Petroleum*, nor that unconscionability may be a distinct exception.

[30] In *LEC Contractors (M) Sdn Bhd* the Court of Appeal took a different position. It found that only fraud which must be pleaded, can be an exception. In that case it was held that:

> A mere allegation of fraud is not sufficient. Fraud must be specifically pleaded and proved. In the instant case, not only fraud was not specifically pleaded in the pleadings but also the instances of fraud submitted in the submission were clearly not instances of fraud but dispute between parties. Although it is clear from the authorities, the dispute must be settled and it would affect the performance bond, but unconscionable conduct or bad faith by itself is not fraud. What is more important to justify any injunction to stop payment is that there must be clear evidence of fraud on the part of the first defendant which comes to the knowledge of the second defendant. As the second defendant has no knowledge of any fraud or

A that fraud was ever given to its notice, it had no choice but to honour the performance bond and meet the demand of the first defendant.

In that case the Court of Appeal also held that the performance bond should be looked at on its face value to determine whether it was a conditional or a non conditional bond. And since it was found that it was an on-demand bond, the court should not be concerned whether an actual breach had been committed or not. Unconscionability as a distinct ground to restrain a call on a performance bond was not discussed in that case.

[31] The Supreme Court in *Esso Petroleum Malaysia Inc* when faced with this issue looked directly into the contractual interpretation of the performance bond itself and the bank's obligation under it instead of the nature of the transaction between the contracting parties under the underlying contract. In other words, the court was merely concerned with the bank honouring its obligation under the guarantee and would not enquire into any breach of either party in the underlying contract. The Supreme Court supported the view that only fraud can be an exception to the autonomy principle of the agreement between the beneficiary and the bank, and cited with approval the passage of Kerr J in *Harbottle* which we adverted to earlier in this judgment. Contrary to Sumatec's counsel reading of the case, we find that there was no finding on unconscionability in *Esso Petroleum* although one of the grounds advanced to maintain the injunction restraining the buyer/appellant from receiving moneys under the performance bond was that the delays in the delivery of materials by the seller/respondent was caused by the buyer/ appellant's own refusal to accept the goods. The other ground was that Esso had not at the time it accepted the delayed goods, indicated its intention to claim damages. These grounds could have triggered a discussion on unconscionability but no argument was advanced in that direction and as such the Supreme Court did not consider it.

[32] Thus, the position as stated by *Esso Petroleum* would be to merely interpret the performance bond or a letter of guarantee to determine whether it is conditional or unconditional, the latter being a security that is readily, promptly and assuredly realisable on demand by the beneficiary (see also *IE Contractors v Lloyd's Bank* [1990] Lloyd's Rep 496 which deployed the same approach for unconditional bonds). Liability will not be dependent upon a proof of any breach under the underlying contract. This would be decided at the trial. And the bank is not concerned with the incidence of any actual default.

[33] It would seem from the modern authorities we have read, that in the case of on demand letters of guarantee or performance bonds the courts are now more willing to look beyond the fraud exception and consider unconscionability as a separate and independent ground to allow for a restraining order on the beneficiary.

[34] The rationale for embracing this equitable exception can be seen from this passage of the Australian High Court decision of *Stern v McArthur* (1988) 165 CLR 489, where it was said:

> The general underlying notion is that which has long been identified as underlying much of equity's traditional jurisdiction to grant relief against unconscientious conduct, namely, that a person should not be permitted to use or insist upon his legal rights to take advantage of another's special vulnerability or misadventure for the unjust enrichment of himself …

[35] In Australia unconscionable conduct is prohibited by her Trade Practices Act 1974 with the introduction of the new Pt IV A in 1992, in both commercial dealings (ss 51AA and 51AC) and in consumer transactions (s 51AB). The Victorian Court of Appeal in *Olex Focas Pty Ltd v Skodaexport Co Ltd* (1998) 3 VR 380 (a case involving the autonomy of standby letter of credit) observed that the effect of this Act 'is to work a substantial inroad into well established common law autonomy of letters of credit and performance bonds and other guarantees'. The Victorian Court of Appeal however affirmed the Supreme Court decision of Batt J at first instance to disallow an injunction on the ground of unconscionability under s 51AA opining that the calling of a performance bond in order 'to exert commercial pressure on the account party to achieve an advantageous settlement of a dispute is not itself unconscionable' (see article by *Hang Yen Low*). Justice Batt held that gross unconscionability falling short of actual fraud is not a ground for an injunction under the general law. His honour noted that there was no definition of the word 'unconscionability" in the Act and referred to the *Oxford English Dictionary* its meaning which defines that word as 'showing no regard for conscience; not in accordance with what is right or reasonable'.

[36] We are also in agreement with Mohamad Ariff bin Md Yusof JC in the case of *Focal Asia Sdn Bhd* when he expressed this opinion on these two exceptions and the test to be applied:

> If there is clear evidence of fraud in the underlying contract, or unconscionability, the court can interfere. In these two situations, the integrity and autonomy of the document will not be compromised, since the paying bank will not be directly prevented from acting on the document. It is the beneficiary that is prevented from making a call on the document on these grounds. Nonetheless, the evidence allowing intervention by the court must be clear. I accept the test of 'seriously arguable that the only realistic inference is fraud' as good law in an interlocutory application such as the present.

[37] In the United Kingdom, the fraud exception to the autonomy principle is to be proved to the appropriate test which in *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All ER 976 placed it at a level of 'very

clearly established fraud'. Lord Denning MR in that case also stated that the fraud exception applied to both fraud in the documents and in the underlying contract and in circumstances in which the beneficiary has knowledge at the time of the presentation. Lord Denning MR stated this:

> That case shows that there is this exception to the strict rule; the bank ought not to pay under the credit if it knows that the documents are forged or that the request for payment is made fraudulently in circumstances when there is no right to payment.

[38] In Canada the *Edward Owen's* test of 'clearly established fraud' has been somewhat diluted to the less stringent test of a 'strong prima facie case' of fraud, (see *CDN Research Development Ltd v Bank of Nova Scotia* (1980) 18 CPC 62 (Ont HC). The fraud also need not be merely confined to the tendered documents but extended to the underlying contract (see *Bank of Nova Scotia v Angelica-Whitewear* (1987) 36 DLR (4th) 161, SC.

[39] We are of the considered view that the 'seriously arguable and realistic inference' test as used by the learned judicial commissioner in *Focal Asia* is equally applicable to the extended exception of unconscionability. That test therefore needs to be applied to the relevant material facts before the court. The same test which results in a 'strong prima facie case' was utilised by the Court of Appeal at the intermediate appeal stage. And the Court of Appeal said this of the required burden now rested on the shoulder of Sumatec:

> As in the case of fraud, to establish 'unconscionability' there must be placed before the court manifest or strong evidence of some degree in respect of the alleged unconscionable conduct complained of, not a bare assertion. Hence, the respondent has to satisfy the threshold of a seriously arguable case that the only realistic inference is the existence of 'unconscionability' which would basically mean establishing a strong prima facie case. In other words, the respondent has to place sufficient evidence before the court so as to enable the court to be satisfied, not necessarily beyond reasonable doubt, that a case of 'unconscionability'being committed by the beneficiary (the appellant) has been established to an extent sufficient for the court to be minded to order injunction sought. This additional ground of 'unconscionability' should only be allowed with circumspect where events or conduct are of such degree such as to prick the conscience of a reasonable and sensible man.

We are in agreement with those propositions.

[40] After the close of submissions, we were served, on 15 December 2011, by learned counsel of Sumatec, an additional submission citing a recent decision of the Court of Appeal which had discussed the very question now posed to us in this appeal. MRC responded via its letter dated 28 December 2011. This was the case of *Kejuteraan Bintai Kindenko Sdn Bhd v Nam Fatt Construction Sdn Bhd & Anor* [2011] 7 CLJ 442. We have scrutinised that

decision and the reasons for the findings of the learned judges in that case. We are inclined to agree wholly with the principles enunciated by the court there. The Court of Appeal agreed with *Focal Asia* that the principle recognising unconscionability as a separate and distinct ground to restrain a beneficiary from making a call on a performance bond accorded with good commercial sense. We also agree with these other holdings of the Court of Appeal:

(i) In my view, consonant with the principle as laid down by my learned brother, unconscionability is a doctrine which allows courts to deny enforcement of a contract because of abuses arising out of the contract.

(ii) In my view the principle underlying the unconscionability doctrine is the prevention of oppression and unfair conduct; and because the determination of unconscionability is fact specific, courts must consider such a claim on a case by case basis and assess the totality of the circumstances.

(iii) A distinction must be drawn between an injunction to restrain a bank/issuer from making payment out on a performance bond (which is governed by the performance guarantee agreement) and an injunction to restrain a beneficiary from making a demand on the bond (which is governed by the underlying contract between the parties).

(iv) All the facts and circumstances surrounding the demands made by the first respondent on both the performance bonds were so lacking in good faith and amounted to unconscionable conduct that it warranted court intervention by way of injunction to avoid injustice. The demands on the bonds were premature, invalid and of no effect.

[41] A determination on whether unconscionability applies in a particular case would therefore depends largely on the material facts. Coincidentally, the same learned appeal judge wrote the lead judgment in *Kindenko* and in this case. The injunction was allowed in *Kindenko* and refused in this case.

[42] So, to answer the question posed to us, we say yes, unconscionability may now be raised as a distinct ground, to restrain a beneficiary under a bank guarantee or performance bond.

[43] In this appeal, Sumatec raised several incidences of the alleged unconscionable conduct on the part of MRC as particularised earlier in this judgment. These are factual matters which have been carefully evaluated and answered below in the Court of Appeal (see paras 32–38 of the Court of Appeal judgment). The learned judges rightly concluded based on the materials before them, that unconscionability had not been proven to maintain the injunction granted below. We defer to these findings of facts by the Court of Appeal. We cannot find any reasons to justify an interference with the appellate judges' exercise of their discretion to set aside the injunction. It is unnecessary for us to add, minus or expand on the reasons given by the Court of Appeal to its

A negative finding of unconscionability on the part of MRC. We also agree with the Court of Appeal that the balance of convenience favoured refusal of the injunction.

[44] For these reasons this appeal is dismissed with costs.

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Appeal dismissed with costs.

Reported by Kanesh Sundrum

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